### BY THE U.S. GENERAL ACCOUNTING OFFICE

## Report To The Secretary Of Housing And Urban Development

# HUD's Second-Year Implementation Of The Federal Managers' Financial Integrity Act

GAO reviewed the implementation of the Federal Managers' Financial Integrity Act of 1982 by 23 federal departments and agencies. The act was intended to help reduce fraud, waste, and abuse in federal government operations by requiring agencies to assess and report annually on the adequacy of their internal controls and accounting systems.

This report highlights the progress made and problems encountered by the Department of Housing and Urban Development (HUD) during its second year under the act. GAO evaluates HUD's efforts to correct internal control weaknesses and improve its accounting systems and discusses ways in which HUD can strengthen its internal control and accounting system evaluations.



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## UNITED STATES GENERAL ACCOUNTING OFFICE WASHINGTON, D.C. 20548

RESOURCES, COMMUNITY, AND ECONOMIC DEVELOPMENT DIVISION

B-216946

The Honorable Samuel R. Pierce, Jr. The Secretary of Housing and Urban Development

Dear Mr. Secretary:

This report presents the results of our review of the Department of Housing and Urban Development's second-year implementation of the Federal Managers' Financial Integrity Act of 1982. Our review was part of GAO's government-wide assessment of the act's second-year implementation by 23 agencies.

This report contains recommendations to you on pages 27 and 36. As you know, 31 U.S.C. 720 requires the head of a federal agency to submit a written statement on actions taken on our recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Operations not later than 60 days after the date of the report and to the House and Senate Committee on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

We are sending copies of this report to the Director, Office of Management and Budget; appropriate congressional committees; and other interested parties.

Sincerely yours

Dexter Beach

Director

Responding to continuing reports of fraud, waste, and mismanagement in federal programs, the Congress enacted the Federal Managers' Financial Integrity Act (FMFIA) in 1982. By requiring agencies to annually evaluate and report on their internal control and accounting systems, the act provides a discipline for agencies to identify, remedy, and report on internal control and accounting problems that hamper effectiveness, potentially cost taxpayers billions of dollars, and erode the public's confidence in the government. The Department of Housing and Urban Development (HUD), which disbursed about \$16.5 billion in 1984, is implementing departmentwide efforts to evaluate and improve internal controls as required by the act.

In evaluating HUD's second-year implementation, GAO examined

- --improvements in internal controls and the process used by HUD to evaluate and correct control weaknesses,
- -- the status of HUD's accounting systems and evaluations made to determine whether they conform to GAO requirements, and
- -- the accuracy and completeness of the Secretary's annual report on internal controls and accounting systems.

### **BACKGROUND**

The act requires all federal agencies to establish, in accordance with standards prescribed by the Comptroller General, internal accounting and administrative controls to ensure that obligations and costs are in compliance with applicable law; assets are safeguarded against fraud, waste, and mismanagement; and revenues and expenditures are properly recorded and accounted for. (See p. 1.)

Agency heads must annually evaluate and report to the President and the Congress on whether their internal control systems comply with the act's requirements. To the extent systems do not comply, the report must identify material weaknesses in their systems together with plans for corrective actions. They also must report on whether their agency's accounting systems conform to the Comptroller General's accounting principles, standards, and related requirements. (See p. 2.)

To provide the framework for implementation, as prescribed by the act, GAO issued standards for agencies to meet in establishing their internal control systems. The Office of Management and Budget (OMB) also has published guidelines that require managers to analyze programs and functions to determine their vulnerability to waste, fraud, and mismanagement. HUD established procedures that its components are using to meet GAO standards and OMB guidelines. Activities found vulnerable must be further evaluated to determine how internal controls can be strengthened or, if the cause of vulnerability is known, what corrective actions can be taken immediately. (See pp. 1 to 3.)

#### RESULTS IN BRIEF

HUD is correcting known internal control problems and is continuing to make progress in developing its process for evaluating and correcting internal controls. However, it needs to further strengthen several aspects of its process for measuring and correcting program vulnerability. (See p. 13.)

HUD did not perform a detailed evaluation of its accounting systems for conformance with GAO's requirements but concluded that they did not conform on the basis of knowledge of long-standing problems. HUD has made a number of systems improvements but expects it will be several years before its systems will conform. HUD has also begun to evaluate its systems. (See pp. 29 and 35.)

GAO agrees with the Secretary's report that HUD's internal control evaluations have not progressed to the point where HUD has reasonable assurance that the act's objectives have been met. GAO further agrees that the accounting systems identified in the Secretary's report are not in conformance with GAO's requirements.

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### **Executive Summary**

## PRINCIPAL FINDINGS

Improving internal controls

Evaluating internal controls

Although HUD's Secretary stated in his annual report that HUD does not have reasonable assurance that its internal controls meet the act's objectives, he reported that during 1984 HUD made progress in addressing internal control weaknesses by completing 205 of 319 corrective actions relating to material weaknesses. The effectiveness of HUD's actions, however, cannot be determined until they are fully implemented and evaluated. (See pp. 7 and 12.)

During its second year under the act, HUD continued and refined the process for evaluating internal controls that it initiated in 1983, extended its evaluations to its regional offices, and continued headquarters evaluations. specifically, HUD's efforts included (1) assessing the vulnerability of about 1,200 regional office units to fraud, waste, and mismanagement, (2) completing analyses (preliminary reviews) of 115 of these vulnerability assessments to develop corrective actions, and (3) developing a framework for evaluating ADP controls. (See pp. 13 to 16.) While HUD has made progress, it can take appropriate actions to strengthen its FMFIA implementation efforts in several areas.

Regional office vulnerability assessments that GAO sampled did not provide space to identify weaknesses requiring immediate corrective actions. In addition, 15 of the 20 assessments did not adequately explain and document the basis for the vulnerability rating. (See pp. 16 to 18.)

In 10 of the 21 preliminary reviews GAO evaluated, the nature and extent of the weaknesses and corrective actions were not clearly defined. As a result, it will be difficult for HUD managers to effectively implement corrective actions. (See p. 20.)

HUD's preliminary reviews did not involve testing of internal controls to determine whether they were operating as intended. Instead, HUD relied largely on evaluators' knowledge and past reports from field reviews and audits. HUD would be in a better position to report on the condition of its

### **Executive Summary**

controls in program areas if it performs more internal control reviews that include testing. HUD also recognizes this need and has contracted for additional reviews. (See p. 12.)

## Accounting systems status

As he did in his first annual report, the Secretary concluded that HUD's accounting systems were not in conformance with GAO's accounting principles and standards. He based his conclusion on the results of prior HUD, Inspector General, and GAO reports that were critical of HUD's systems rather than on examinations that tested the systems in operation. However, HUD began such examinations in fiscal year 1985. The Secretary also elaborated on the condition of HUD's major systems and actions to improve them. HUD anticipates bringing its systems into conformance by fiscal year 1988. (See p. 30.)

#### RECOMMENDATIONS

To strengthen HUD's internal control program, GAO makes recommendations to HUD's Secretary that include

- --revising vulnerability assessment guidelines to provide examples of proper documentation necessary to support the rating assigned;
- --revising preliminary review guidelines to require evaluators to better explain weaknesses and corrective actions; and
- --completing evaluations of accounting systems for conformance with the Comptroller General's principles, standards, and related requirements. (See pp. 27 and 36.)

### AGENCY COMMENTS

HUD said that it was in general agreement with GAO's recommendations and that evaluation efforts such as GAO's were helpful to HUD in improving its internal control program. In addition, HUD made several comments aimed at clarifying information contained in GAO's draft report. These comments have been incorporated into the report where appropriate. (See app. II.)

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ABBREVIATIONS						
ADP	Automatic Data Processing					
FMFIA	Federal Managers' Financial Integrity Act					
GAO	General Accounting Office					
HUD	Department of Housing and Urban Development					
ICR	Internal control review					
IG	Inspector General					
OIG	Office of Inspector General					
OIPS	Office of Information Policies and Systems					
OMB	Office of Management and Budget					

### CHAPTER 1

### INTRODUCTION

In September 1982 the Congress enacted the Federal Managers' Financial Integrity Act (FMFIA) of 1982 [31 U.S.C. 3512 (b) and (c)] in response to disclosures of fraud and waste in government operations. The act's purpose was to strengthen the existing requirements of the Accounting and Auditing Act of 1950 that executive agencies establish and maintain systems of accounting and internal control to provide effective control over and accountability for all their funds, property, and other assets. By requiring agencies to annually evaluate and report on their internal control and accounting systems, the act provides a discipline for agencies to identify, remedy, and report on internal control and accounting problems that hamper effectiveness, potentially cost taxpayers billions of dollars, and erode the public's confidence in the government.

This report on the Department of Housing and Urban Development (HUD) is one of a series of reports by GAO on federal agencies' second-year implementation of the FMFIA. In 1984 we issued reports on 22 agencies' implementation efforts during the first year, including a report on HUD. 1

### THE ACT'S REQUIREMENTS

Section 2 of the act requires each executive agency to establish and maintain internal controls that comply with the internal control standards prescribed by the Comptroller General<sup>2</sup> and to provide reasonable assurances that

- --obligations and costs are in compliance with applicable law;
- --funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and
- --revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports to maintain accountability over the assets.

HUD S First-Year Implementation of the Federal Managers' Financial Integrity Act (RCED-84-140, July 20, 1984).

<sup>&</sup>lt;sup>2</sup>The Comptroller General issued <u>Standards for Internal Controls</u> in the Federal Government in June 1983.

The act further requires the agency heads to evaluate and prepare an annual report on whether their internal control systems fully comply with the act's requirements. To the extent systems do not comply, the act requires the agencies to identify any material weaknesses<sup>3</sup> in the internal controls and to describe their plans to correct these weaknesses.

Further, the act requires that the Office of Management and Budget (OMB) issue guidelines for the agencies to use in evaluating the internal accounting and administrative controls. OMB issued these guidelines in December 1982.

Section 4 of the act requires the agencies to include in their annual report a separate statement on whether their accounting systems conform to the principles, standards, and related requirements prescribed by the Comptroller General.<sup>4</sup>

### OMB GUIDELINES

To provide a framework for implementation as prescribed by the act, OMB, in consultation with GAO, established guidelines for agencies' use in evaluating, improving, and reporting on the internal control systems. The guidelines recommended a seven-phased approach:

- --Organize the process to make sure it is done efficiently and effectively. Primary considerations for organizing include specific assignment of responsibilities, the Inspector General's role, quality assurance over the process, internal reporting, documentation requirements, personnel and supervision, and scheduling the evaluation process.
- --Segment the agency into organizational components and then into units (programs and administrative functions within each component) to be assessed. These units are called "assessable units."

<sup>&</sup>lt;sup>3</sup>Material weaknesses are defined by the House Committee on Government Operations as those matters that could (1) impair fulfillment of an agency's mission, (2) deprive the public of needed government services, (3) violate statutory or regulatory requirements, or (4) result in a conflict of interest.

<sup>4</sup>The GAO Policy and Procedures Manual for Guidance of Federal Agencies contains the principles, standards, and related requirements to be observed by federal agencies.

- --Assess the vulnerability of each assessable unit to the occurrence of waste, loss, unauthorized use, or misappropriation. These vulnerability assessments consist of three steps: (1) analysis of the general control environment (environmental factors, such as management attitude, which could affect internal controls), (2) analysis of inherent risk (factors inherent in the unit that create potential for loss, such as a large budget), and (3) preliminary evaluation of safeguards (an evaluation of the methods used to protect the assets).
- --Develop plans and schedules for performing internal control reviews and other actions such as doing audits or modifying procedures. These actions should be based on the results of the vulnerability assessments and other considerations such as management priorities and resource constraints.
- --Review the internal controls for the selected areas to determine whether adequate control objectives (goals or conditions) have been established and control techniques (methods of protecting resources) exist and are functioning as intended, and then develop recommendations to correct weaknesses in either the design or functioning of the internal control system. OMB defines an internal control review (ICR) as a detailed examination of internal controls. An important part of such an examination is testing these controls to ensure that they are functioning as intended. Testing can consist of selecting a sample of transactions and reviewing the documentation for the transactions as well as making other observations and inquiries.
- --Determine, schedule, and take corrective actions to improve internal controls on a timely basis and in a cost-effective manner.
- --Prepare the annual report to the President and the Congress on the status of the agency's system of internal control. This report should say whether the evaluation of internal controls was conducted in accordance with OMB's internal control guidelines and whether the agency's system of internal accounting and administrative control complies with the Comptroller General's standards and provides reasonable assurance that the objectives of internal control were achieved. The report should also identify material weaknesses, if any, in the agencies' system of internal control, and describe the plans and schedule for correcting these weaknesses. The status of actions taken to correct weaknesses identified in prior years' reports also is to be included.

## HUD: CREATION, PURPOSE, AND ORGANIZATION

HUD was established by the Housing and Urban Development Act, Public Law 89-174, 79 Stat. 667 (1965) (Codified at 42 U.S.C. 3531-3537). HUD's functions and authority have expanded and encompass a broad mission of providing adequate housing, promoting community and economic development, and eliminating discrimination in housing markets.

HUD's major programs include: (1) Housing assistance programs and mortgage insurance programs, which provide low- and moderate-income families with home-ownership opportunities and rental housing assistance, (2) community development programs, including the Community Development Block Grant Programs and the Urban Development Action Grant Program, which provide federal assistance to communities for improving housing conditions, conserving energy supplies, expanding business opportunities, providing jobs, and revitalizing blighted areas in the nation's cities and counties, and (3) fair housing and equal opportunity programs, which provide financial assistance to state and local agencies to help them eliminate housing discrimination. administers these programs through its headquarters office, 10 regional offices, and 81 field offices. During fiscal year 1984, HUD had disbursements of about \$16.5 billion and employed about 12,000 full-time staff.

## OBJECTIVES, SCOPE, AND METHODOLOGY

Our objectives were to (1) update and evaluate HUD's progress in implementing its processes for evaluating its internal control and accounting systems, (2) determine whether, through corrective actions, HUD is improving its internal control and accounting systems, and (3) assess the reasonableness of HUD's second annual report to the President and the Congress.

We conducted the review jointly with HUD's Office of Inspector General (OIG) under an agreement between the Comptroller General and HUD's Inspector General. The review concentrated on three of HUD's largest activities: housing, community planning and development, and its administrative functions in the Office of the Assistant Secretary for Administration. The Inspector General's staff was responsible for review work in the Office of Community Planning and Development and parts of administration at HUD headquarters and at its regional offices in Atlanta, Georgia, and Seattle, Washington.

We were responsible for the work in HUD's headquarters Office of Housing and Office of Finance and Accounting in Administration, including HUD's efforts under section 4 of the act, and for work at HUD's regional offices in Chicago, Illinois, and Fort Worth, Texas. We shared the information obtained. The OIG issued a separate report to the Secretary of HUD. We performed our audit work between August 1984 and February 1985.

With respect to HUD's efforts under section 2, we interviewed HUD officials and reviewed HUD guidelines, reports, and supporting documentation relating to the internal control evaluation process.

During fiscal year 1984, HUD made the assessments and reviews shown in table 1.1 under its internal control evaluation process.

Table 1.1
HUD Assessments and Reviews

	<u>Headquarters</u>	Regional <u>offices</u>	Total
Vulnerability assessments	52	1,214	1,266
Preliminary reviews	67	115	182
Internal control reviews	22	0	22

We selected randomly and reviewed 20 of 231 vulnerability assessments and 14 of the 20 preliminary reviews<sup>6</sup> in HUD's Fort Worth and Chicago regional offices, and 7 of the 16 preliminary reviews in the Office of Housing at HUD headquarters. We selected those assessments and reviews

<sup>5</sup>Review of HUD's Implementation of OMB Circular No. A-123 and the Federal Managers' Financial Integrity Act of 1982 as of September 30, 1984, 85-AO-169-0002, Nov. 19, 1984.

<sup>&</sup>lt;sup>6</sup>A preliminary review is a step in the review process initiated by HUD. It is intended to quickly identify problems that are to be addressed with available knowledge and initiate corrective actions, and identify those areas where knowledge is not sufficient to define the problem. In the latter case, the evaluator can request an ICR or some other action, such as an audit.

scheduled for completion in fiscal year 1984 in HUD's major programs and activities—housing, community planning and development, and administration (except the Office of Finance and Accounting). We also reviewed 5 ICRs selected randomly from the 19 ICRs HUD had scheduled for completion during fiscal year 1984 in the Office of Finance and Accounting. We reviewed these documents for compliance with HUD, OMB, and GAO guidelines and requirements.

The OIG reviewed 15 of the 267 vulnerability assessments and 8 of the 20 preliminary reviews in HUD's Atlanta, Georgia, and Seattle, Washington, regional offices. The Inspector General's staff also reviewed 6 of the 11 preliminary reviews in HUD headquarters' Office of Administration (except finance and accounting) and Office of Community Planning and Development.

With respect to HUD's efforts under section 4 of the act, we reviewed (1) documentation supporting HUD's accounting system review process, (2) relevant GAO and HUD Inspector General reports issued between 1979 and 1984 and HUD ICRs issued between October 1983 and September 1984 to determine the extent to which HUD reported identified system weaknesses, and (3) the documentation supporting HUD's systems development. We also interviewed HUD officials responsible for accounting systems reviews, development, and enhancement.

We also reviewed the reasonableness of HUD's second annual report issued in 1984 to the President and the Congress under both sections 2 and 4. We conducted our work in accordance with generally accepted government auditing standards.

### CHAPTER 2

### CONTINUED PROGRESS IN

### IMPLEMENTING THE ACT

In the second year under the act, HUD has initiated and completed actions to address identified weaknesses in internal controls. In its second annual report, HUD reported it had completed 205 corrective actions and that it had 114 in process to address material weaknesses. Our sample of four of these weaknesses showed that corrective actions had been completed for two and were in process for two. The latter two weaknesses related to determining subsidy payments to public housing agencies. For fiscal year 1984 HUD obligated about \$1 billion for these subsidies. HUD has concluded, however, that it needs to do many more in-depth reviews of its programs and functions before it will have reasonable assurance that all objectives of the act have been met.

## PROGRESS BEING MADE IN CORRECTING MATERIAL WEAKNESSES IDENTIFIED IN 1983

HUD has made progress in addressing the material weaknesses identified in its 1983 annual report to the Congress and the President. In that report, HUD identified material weaknesses in 28 program and administrative areas (generally one weakness per area) and outlined actions to correct these weaknesses. In its 1984 report HUD reported new material weaknesses in 13 areas. It also reported that it had completed 205 corrective actions and that 114 were in process.

Our review of actions to correct four material weaknesses reported for housing programs in the 1983 report showed that HUD has made progress in correcting these weaknesses. These material weaknesses we reviewed relate to

- --inflated or questionable appraisals in the single-family mortgage insurance program,
- --property maintenance activities for single-family housing owned by HUD,
- --underpayment of rents by some public housing tenants, and
- --overpayments of operating subsidies to some public housing authorities.

## Inflated appraisals of single-family homes

The Secretary's 1983 report to the President and the Congress identified a material weakness in HUD's single-family mortgage insurance program. Under this program, HUD insures home mortgages on the basis of the appraisal value of the home. If the borrower defaults on the mortgage, HUD will reimburse the lender and become the owner of the property. During fiscal year 1984, HUD insured about 471,000 such mortgages.

HUD reported that during periods of high volume it did not have sufficient field office staff to review appraisal reports. Thus, HUD reported it may be insuring mortgages for excessive amounts that could result in excessive payments if the borrower defaulted. HUD also reported that using Veterans Administration Certificates of Reasonable Value as a basis of establishing value for HUD insurance commitments has led to over-valuation of some properties.

To address those weaknesses, HUD implemented corrective actions including using fee appraisers (non-HUD personnel) to review appraisal reports and requiring the inclusion of photographs of comparable properties in appraisal reports. With respect to the use of Veterans Administration certificates, HUD concluded that an in-depth review of defaults and foreclosures has indicated no additional risks from using these certificates and that no additional action is necessary.

## Weaknesses in property maintenance and repair of HUD-owned housing

A second material weakness involved HUD's property maintenance and repair activities. HUD obtains ownership of single-family houses when borrowers default on HUD-insured mortgages and the lender forecloses. HUD reimburses the lender and obtains title to the property. Until HUD resells the property, it must maintain it. HUD contracts for maintenance and preparation of HUD properties for resale. As of September 30, 1984, HUD owned about 20,000 such properties.

HUD reported that weaknesses in supervising and monitoring property maintenance and repair activities have resulted in instances of fraud convictions of HUD field staff and contractors.

To address the situation, HUD proposed five actions: (1) divide procurement actions so no one person has complete control, (2) provide regional guidance on monitoring contractors, (3) develop a checklist for monitoring contract performance, (4) require field offices to have a documented procurement plan, and (5) complete a survey by HUD's OIG of

contractor's expenditures. All actions have been completed. With respect to the OIG survey, an OIG official told us that preliminary work indicated that this survey was not necessary.

## Collecting correct tenant rent in the public housing program

HUD reported that it is widely perceived that public housing tenants are paying less rent than they should because they have not reported all sources of income to the public housing authority. Major concerns cited by HUD were: lack of statutory authority to require tenants and applicants to provide social security numbers; lack of systematic quality control of housing authority determinations; and lack of a system for matching tenant records with state wage data and information collected under income-maintenance programs, such as Aid to Families with Dependent Children and Food Stamps.

HUD proposed several actions such as revising program handbooks and a verification program to compare tenants' income records with wage data and income maintenance programs. Initially, HUD estimated completing these actions during 1984. According to a HUD official, however, completion has been extended until fiscal year 1985 because HUD is still seeking necessary legislative changes.

## Overpayments of public housing operating subsidies

Another material weakness reported by the Secretary was based on the Inspector General's reports that some public housing agencies have received overpayments from HUD operating subsidies. These overpayments resulted from understating projections of local income (investment, rental, and other income), which are used in determining the subsidy. In fiscal year 1984 HUD obligated \$1.2 billion for such subsidies. This problem went undetected through weaknesses in HUD's monitoring of income projections made by the public housing authorities and the failure of independent public accountant audits to disclose individual instances of noncompliance with regulations.

In April 1984 the Office of Public and Indian Housing directed HUD regional offices to reexamine public housing authorities' income estimates. This initial directive was followed by procedural memoranda focusing on housing authorities with 500 or more units. HUD also proposed changes in its regulations that would require year-end reconciliation of projections to actual income earned by authorities. HUD anticipates that this rule will be implemented by September 1985.

In discussing corrective actions, the HUD program staff and the HUD Internal Control Coordinator told us that the effectiveness of these actions will be determined through HUD field reviews and reevaluating the vulnerability of the assessable units.

## HUD CONCLUDES IT DOES NOT HAVE REASONABLE ASSURANCE OF MEETING ACT'S OBJECTIVES

On December 31, 1984, HUD issued its second annual report to the President and the Congress on the adequacy of its system of accounting and administrative controls. The Secretary, as he did in the first annual report, concluded that HUD's evaluation of its system of internal controls had not progressed to the point where HUD has reasonable assurance that the act's objectives have been met. The Secretary also concluded that because of the decentralization and complex nature of HUD programs, HUD must conduct many more in-depth reviews of its major activities in headquarters and the field and further strengthen the overall evaluation process before HUD will have such assurance.

The Secretary's report, however, identified new material weaknesses in 13 program and administrative areas, including single-family housing, community planning and development, the Government National Mortgage Association, and administration. The report also identified actions to correct these weaknesses and established target dates for completing these actions. Examples of two areas are:

- --HUD reported that a recent audit indicated that lost revenues and increased costs had occurred in the single-family bulk sales program. HUD identified six actions to address this problem, such as discontinuing payment of sales commissions on bulk sales and identifying questionable sales commissions and referring such cases to the Inspector General for investigation. HUD indicated that five of the six actions would be implemented during 1984, and the sixth, conducting headquarters' reviews of completed bulk sales for compliance with policy directives, would be done periodically.
- --In the Indian Community Development Block Grant Program, HUD cited long-standing problems and the need to find cost-beneficial solutions. HUD plans to conduct an ICR of this area to be completed during fiscal year 1985.

<sup>&</sup>lt;sup>1</sup>Under this program, HUD field offices sell packages of federally owned properties. Emphasis is on marketing hard-to-sell properties and returning properties to private ownership in a fast and economical manner.

Although HUD has identified internal control weaknesses and has scheduled actions intended to correct these weaknesses, the identification of the weaknesses was generally not based on a systematic, in-depth analysis of internal controls. Thus, it may not constitute a complete evaluation of the condition of HUD's internal controls. HUD has recognized the need for more in-depth reviews and has plans to do five ICRs in program areas during 1985.

OMB guidelines provide two basic approaches to assessing an agency's internal controls over its programs and functions. One is performing ICRs. The other approach is considering a series of options for each of the highly or moderately vulnerable program and administrative functions. OMB stated that this could be done by evaluating the degree and causes of the vulnerabilities and then determining the appropriate courses of action, taking into consideration management priorities, resource availability, and other management initiatives underway. These actions might include conducting ICRs, requesting an audit, training staff, or modifying procedures or documents. OMB indicated that this approach helps ensure that resources devoted to the internal control process are used efficiently and effectively.

Except for the ICRs in its Office of Finance and Accounting, HUD has adopted the second approach. Through its preliminary review process, HUD has evaluated the causes of vulnerability identified in the vulnerability assessments and acted to address the control weaknesses identified. By the end of its second year under FMFIA, HUD had completed preliminary reviews of all headquarters' highly and moderately vulnerable units and about 20 percent of the regional office highly and moderately vulnerable units. It also completed one ICR in a major program area—single-family housing. As a part of its review process, HUD identified about 950 corrective actions.

Although the preliminary reviews have identified control weaknesses, these reviews are not intended to be comprehensive and in-depth evaluations of assessable units. Preliminary reviews are based on the vulnerability assessment, and much reliance is placed on the evaluator's personal knowledge of headquarters and field activities and past reports from field reviews and audits. HUD instructions specifically state that conclusions reached in the preliminary review must be supported by data. However, the instructions further state that if extensive data collection or field research is required in order to analyze the assessable unit, then an ICR is warranted.

In discussing the two approaches to assessing internal controls, OMB guidelines state that under either approach an agency must ensure that the actions taken will determine whether the existing controls are operating as intended. We believe

that one way to ensure this is to identify the specific control techniques needed and test them to determine whether they are operating properly.

HUD also has recognized this need. In its second annual report to the President, HUD has stated that the completion of many more in-depth reviews of major activities is a necessary step before it will be in a position to give reasonable assurances that the act's objectives have been met. In this regard, HUD has contracted for three ICRs to be done in Public and Indian Housing and is planning to contract for two additional ICRs in fiscal year 1985. According to the HUD Internal Control Coordinator, the purpose of these contracts, in addition to reviewing internal controls, is to show program staff how to do ICRs and to gain program staff acceptance of the process. The coordinator said HUD currently does not have either the resources to perform a large number of ICRs at one time or the program staff expertise to make these reviews.

### CONCLUSION

HUD has been forthright in reporting that its internal control evaluation process has not progressed to the point where it can give reasonable assurance that the objectives of FMFIA have been met. HUD has, however, continued to identify control weaknesses and to take actions to correct these weaknesses. The effectiveness of these actions, however, cannot be determined until they are implemented and evaluated. We believe that as HUD completes more in-depth reviews of its major programs and functions, it will be in a better position in the future to report to the President and the Congress on the condition of its internal controls.

### CHAPTER 3

### IMPROVEMENTS NEEDED

### IN HUD INTERNAL

### CONTROL EVALUATION PROCESS

In its second year under the act, HUD continued to make progress in developing and implementing a process to evaluate and report on its systems of internal control as required by section 2 of the act. Although HUD's process identifies control weaknesses and corrective actions, it could be improved if HUD takes actions to address the following concerns.

- --Vulnerability assessments and preliminary reviews did not always adequately explain the basis for the conclusions reached regarding the adequacy of internal controls and potential vulnerability.
- --Preliminary reviews did not always clearly explain the nature and extent of the control weaknesses or the specific actions necessary to correct the weaknesses. Further, the required analyses for determining whether to perform an ICR were not always completed.
- --ICR reports and files did not always clearly identify where in the supporting working papers the testing of identified control techniques was documented. In addition, the reports and files did not identify the control techniques directly related to the control objective they were intended to achieve.

#### PROCESS FOLLOWED

In implementing its internal control evaluation efforts, HUD essentially followed the steps recommended by OMB. HUD's second-year efforts were a continuation and refinement of the process initiated in 1983.

The Secretary delegated overall responsibility to the Assistant Secretary for Administration who, in turn, delegated day-to-day coordination responsibility to an internal control coordinator, the Chief, Audit and Internal Control Branch, Office of Budget, within the Office of Administration. Each major headquarters organization and each region also designated an individual to coordinate internal control activities.

 $<sup>^{1}\</sup>mbox{HUD}$  efforts under section 4 of the act are discussed in chapter 4.

The Secretary also assigned the Inspector General responsibility for providing technical assistance to the Office of Administration in implementing the act. As he did last year, the Secretary also requested the Inspector General to report on whether HUD's evaluation of the systems of internal control was carried out in accordance with OMB guidelines in a reasonable and prudent manner. The Inspector General reported to the Secretary in November 1984 that although HUD had made progress, it had not completed the full implementation process and that HUD could not provide full assurance that the act's objectives had been met.

### Segmenting

In HUD, the Assistant Secretaries establish their own assessable units. During the first year, headquarters was segmented into about 390 assessable units and each regional office into about 120 assessable units. In September 1984 the Assistant Secretary for Administration requested all principal staff to update their inventory of assessable units. This update was to reflect (1) new programs or major changes in existing programs or procedures, (2) adequate coverage of all programs and functions as identified in the budget or other management documents, (3) management and organizational responsibility for each unit, and (4) programs that had been eliminated. In carrying out this reassessment, HUD developed and used a data collection instrument that identified, among other things, the unit, its scope, and its relationships to cross-cutting functions (accounting systems, automatic data processing (ADP) systems, etc.).

### Vulnerability assessments

During fiscal year 1984, HUD completed vulnerability assessments in its regional offices. According to HUD, the 10 regional offices completed assessments of 1,214 units (about 120 in each region). As a result of these assessments, HUD rated 141 units as being highly vulnerable to waste, fraud, and abuse, 381 units as being moderately vulnerable, and 692 units as having low vulnerability. Personnel from the various regions performed the assessments using a standardized form developed by HUD headquarters.

### Reviewing internal controls

HUD uses two approaches to review its internal controls. In its major program areas and in administration (except the Office of Finance and Accounting), HUD's approach includes a process called preliminary reviews. According to HUD, these reviews analyze the vulnerability assessment to (1) quickly identify problems that could be addressed with available knowledge and initiate corrective actions and (2) identify those areas where the current knowledge is insufficient to define the problem and where an ICR or some other action, such as an audit, would be necessary.

During fiscal year 1984 HUD completed preliminary reviews of its headquarters' highly and moderately vulnerable units that were begun last year. HUD also began and completed 115 of these reviews in its regional offices. At the regional office level, the reviews encompassed high-, moderate-, and some low-rated units, with the selection left to the discretion of the regional offices. Overall, according to HUD, these offices have about 522 highly and moderately vulnerable units. HUD plans to continue these reviews in the regions during the third year.

HUD's other approach was to conduct ICRs after completing the vulnerability assessments. At headquarters, HUD personnel completed one ICR in a major program area—single—family housing—and two in its Office of Procurement and Contracts. During fiscal year 1984, a contractor completed 19 ICRs in HUD's Office of Finance and Accounting. These reviews were a part of a series of about 40 reviews to be done by the contractor on accounting operations. HUD reported completing 17 of the 40 ICRs during the first year. HUD has also contracted for the same contractor to do three ICRs in the Public and Indian Housing Program.

### Reviewing ADP controls

HUD relies heavily on its ADP systems for its accounting, financial management, and program operations. In fiscal year 1984 HUD had 143 systems in operation and obligated about \$40 million for these ADP systems. In our report on HUD's first-year implementation of the act (RCED-84-140, July 20, 1984), we concluded that HUD had not emphasized ADP reviews, had not established organizational responsibility for such reviews, and had not provided guidance on how to evaluate ADP controls.

During its second year under the act, HUD has made progress in this area.<sup>2</sup> The Assistant Secretary for Administration assigned the Office of Information Policies and Systems the responsibility for implementing the ADP internal control review process. In addition, HUD defined all principal automated systems as assessable units and began performing vulnerability assessments of these units. As of February 1985 none of these assessments had been completed. Systems not designated as assessable units will be evaluated by program managers as part of their internal control review process. HUD has also provided managers with guidance in checklist form on how to evaluate ADP controls.

In spite of this progress, HUD did not include some areas, including regionally unique systems, in the review process. HUD recognizes this problem and will address it in the future.

<sup>&</sup>lt;sup>2</sup>A more detailed discussion of HUD's ADP efforts as well as HUD's actions on other proposals in our first-year report are included in appendix I.

### Scheduling and tracking corrective actions

HUD established a tracking system to monitor and control the evaluation process. This tracking system was essentially in place last year. As of September 30, 1984, the system was tracking 946 corrective actions, with 407 reported as completed.

### VULNERABILITY ASSESSMENT PROCESS CAN BE IMPROVED

In fiscal year 1984 HUD completed vulnerability assessments in its 10 regional offices. Our review of a sample of 20 of 231 assessments in HUD's Fort Worth and Chicago regions disclosed that 15 of the assessments sampled did not adequately explain the basis for the vulnerability rating assigned to the assessable unit. Proper documentation of the rationale used in reaching conclusions would facilitate subsequent steps in the evaluation process and independent and management evaluations of the quality of the vulnerability assessments. Additionally, the vulnerability assessment form did not provide space for the evaluator to identify weaknesses requiring immediate corrective action and the proposed actions, although HUD instructions required such identification.

### Guidance on documentation can be strengthened

OMB guidelines state that the internal control review process should be documented so that an independent reviewer could understand the basis for the conclusions reached. Vulnerability assessment documentation does not have to be lengthy or complicated. However, it should identify the internal controls and the specific data used to evaluate the adequacy of these controls. Our review showed that the field office vulnerability assessments sampled did not always provide this information. HUD's guidance provided to the regional staff may have contributed to the documentation problems. In our report last year we also observed documentation problems with vulnerability assessments performed at headquarters. (See app. I.)

To accomplish its field office vulnerability assessments, HUD issued a handbook entitled A Guide to Field Office Vulnerability Assessments. This guide included a vulnerability assessment form that addressed seven control techniques. A control technique is a method for protecting resources. For example, a control technique might include organizing in such a manner that key duties such as authorizing and recording transactions are segmented among individuals.

<sup>&</sup>lt;sup>3</sup>Personnel competency, supervision/management, organizational structure, methodologies/procedures, records/documentation, security/control over resources, and management information data systems.

For each technique, the evaluator was requested to (1) answer a series of questions to determine whether the controls exist, the adequacy of the controls, and risk or potential vulnerability and (2) explain and document the answers provided. However, the guidance provided to the regional staff on documenting vulnerability assessments was limited. Although guidance required data sources to be listed, it did not clearly show, through example or otherwise, the specific type of documentation expected.

Our review showed that 15 of the 20 assessments we sampled were not adequately documented to show the basis for the conclusions reached. For two assessments the documentation consisted of the check mark responses to the questions on each control technique with no information to explain the basis for answers. In 13 assessments the documentation provided did not clearly identify the data sources or the basis supporting the assessment of each control technique.

For example, in the Fort Worth Regional Office, the vulnerability assessment for the region's pay functions said that for two of the control techniques, security/control over resources and management information data systems, controls exist and are adequate. However, the assessment did not identify the controls or include specific documentation to support this assessment. The assessment also concluded that methodologies/procedures<sup>4</sup> exist and are functioning. However, in explaining this conclusion, the preparer stated that pay handbooks need revision but did not identify specifically which handbook needed revision or what type of revision was necessary.

After the regional assessments were completed, HUD included additional guidance on documentation in its internal control program handbook. This handbook, issued in March 1984, covered each step in the internal control process. This guidance states that merely completing a vulnerability assessment form does not provide the necessary backup or explanation of decisions made. Each use of judgment, personal knowledge, or fact must be supported by written material to allow the independent person to know all the factors that affected the vulnerability assessment decision or ranking. Documentation includes workpapers, references, and other notes so that data sources may be verified. The new guidance on documentation is better but could be further strengthened by providing examples in the vulnerability assessment instructional handbook of the type of documentation needed for a well-supported vulnerability assessment.

In discussing our findings with the HUD Internal Control Coordinator, he agreed that the assessments could be improved by making the documentation more specific. He also agreed that HUD's

<sup>&</sup>lt;sup>4</sup>HUD defines this technique as the tasks, steps, and methods used to accomplish the Department's goals.

guidance could be improved by including examples of the level of specificity necessary to properly document the process used and the support relied on.

In November 1984 the Inspector General also reported that its sample of regional vulnerability assessments disclosed that they were inadequately documented to enable an independent person, after reviewing the documentation, to understand the basis for the conclusion on the assessment. The report recommended that the Assistant Secretary for Administration expedite the issuance and implementation of quality control procedures, assess the low-rated vulnerability assessments for quality, and return those that do not meet quality standards for correction and possible rerating.

## Vulnerability assessments do not show corrective action needed

Both OMB and HUD guidelines required the reviewer to identify control weaknesses requiring immediate corrective action. However, our review of the regional office vulnerability assessments showed that the assessment forms did not provide space for noting weaknesses requiring immediate corrective action, and none were listed. OMB guidelines stated that any control weaknesses requiring immediate corrective action noted during the vulnerability assessment process should be identified as part of the vulnerability assessment. HUD's instructions stated that if a serious problem or weakness is revealed, the evaluator should develop a recommended action plan and coordinate the proposed action with regional and headquarters personnel. We believe that providing space on the form for identifying weaknesses requiring immediate corrective actions and the proposed actions would emphasize this requirement to the evaluator.

In discussing this matter, the HUD Internal Control Coordinator agreed that the assessment form should include space for outlining corrective actions. He said that HUD is currently working on a revised vulnerability assessment form and instructions that will address our concerns.

### PRELIMINARY REVIEWS CAN BE IMPROVED

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HUD's preliminary reviews are designed to analyze the results of the vulnerability assessment and select a course of action to address issues the assessment identified. The reliability and usefulness of preliminary reviews can be enhanced by better documenting the basis for the conclusions reached, defining more specifically the weaknesses and corrective actions, and ensuring that the review process for determining whether to perform ICRs is properly completed in each case. The Assistant Secretary for Administration has also recognized similar problems with the preliminary reviews and has requested that the regional offices redo many of the regional office reviews.

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### Documentation can be improved

The 21 preliminary reviews we evaluated in HUD's headquarters and Fort Worth and Chicago regional offices were not adequately documented to show the specific data sources used as the basis for the conclusions reached on the adequacy of internal controls and needed corrective actions. The Inspector General also reported weaknesses in documenting preliminary reviews. We believe that proper documentation would facilitate future reviews and management evaluations of the quality of the preliminary reviews.

The preliminary review consists of a questionnaire and an action plan. The questionnaire assists the evaluator in (1) assessing the impact of the unit's vulnerability, (2) assessing the strengths and weaknesses of the same seven control techniques addressed by the vulnerability assessment, and (3) selecting courses of action such as requesting an audit, conducting an ICR, or improving control techniques. The action plan sets forth the action(s) selected and establishes dates for completing the actions.

OMB guidelines state that each step of the evaluation process should be adequately documented and that the documentation should be such that an independent reviewer could examine it and understand the basis for the conclusions reached. HUD's preliminary review instructions request the evaluator to document each review performed. The questionnaire used to evaluate each of the seven control techniques provides a format to document the type of data used and provides five categories—personal observation, data or reports, interviews, field surveys, and other. For each category, the form provides space for the evaluator to cite the source of the data used.

In 6 of the 21 reviews we sampled, the questionnaires were not available for our review. In three cases, the evaluators told us that they did not complete the questionnaire, and in two cases the evaluators said that they had destroyed the questionnaires. In the sixth case, the evaluator was not available and his supervisor could not locate the preliminary review file. For those 15 questionnaires that were available, the data sources provided were very general, such as "audit reports," "closeout papers," and "field visits and reviews."

For example, a Fort Worth preliminary review on development-cost certificates (documents that determine the amount of a multifamily insured mortgage) stated that the information used in evaluating personnel systems, one of the seven control techniques included in the preliminary review, was based on data or reports, interviews, and field surveys. In this case, the preparer concluded that personnel systems were not effective to ensure personnel competency, but the preliminary review did not identify specific documents, reviews, or field visits that led to this conclusion.

Another case involved a headquarters preliminary review concerning the assignment of single-family mortgages. In this case, the evaluator, in assessing the personnel systems control technique, stated that the assessable unit had sufficient systems for ensuring that personnel have the skills, knowledge, and attitudes required to implement operational safeguards. The evaluator indicated that the documentation supporting this determination was based on personal observation, and data and reports but did not identify the specific reports or data.

We believe that HUD's preliminary review instructions may have contributed to the lack of documentation. While the instructions require that data sources be identified, they did not clearly show through example or otherwise the level of documentation expected. Additionally, the instructions recommend, but do not specifically require, that the questionnaire be used and retained.

In discussing the preliminary review documentation with HUD's Internal Control Coordinator, he stated that HUD is revising the entire preliminary review process. He agreed that the instructions should be revised to provide better guidance concerning the type of documentation that is adequate. In this regard, he said HUD is developing a model preliminary review that includes examples of specific documentation. He also said that it was intended that evaluators use the questionnaire and retain it to document the work performed on the preliminary review.

### Weaknesses and corrective actions not always specific

Of the 21 preliminary reviews we examined, 10 did not clearly define the nature and extent of the weaknesses or the specific actions necessary to correct the weaknesses. Specific information in describing the weaknesses and corrective actions is necessary for management to understand the problem, determine the amount of resources needed to correct the problem, and follow up on proposed corrective actions to ensure that they are implemented.

Although HUD instructions do not specifically discuss how much detail should be included in the statement of weaknesses and planned corrective actions, they state that planning corrective actions involves determining who will do what by when and providing a specific set of actions to monitor. However, these instructions do not provide examples to clearly demonstrate the

<sup>&</sup>lt;sup>5</sup>Single-family mortgage assignments to HUD occur when the homeowners do not make mortgage payments to lenders of insured mortgages on time. In certain cases, HUD will take over these mortgages and collect the mortgage payments from the borrower.

level of specificity desired. Our review showed that the preliminary reviews did not always provide sufficient detail to make these determinations.

In Fort Worth, for example, of the three preliminary reviews in our selection that proposed corrective actions, none provided specific information. The reviews involved three housing areas-Public and Indian Housing development-cost certificates, the Public Housing Modernization Program, and housing-assistance payments. All three reviews requested more staff for the programs but did not describe staff needs in terms of specific numbers and types of staff needed. Two of the reviews also proposed obtaining ADP equipment because of excessive staff work load. However, the reviews did not specify the areas requiring automation, the volume of activity involved, or the type of ADP equipment necessary. In addition, three of the seven preliminary reviews we examined in headquarters included increased staff training as a proposed corrective action but did not define the present training level or specify how much additional training was necessary.

The HUD Internal Control Coordinator agreed that statements of weaknesses and corrective actions were not always adequate. He said that the Assistant Secretary for Administration in January and February 1985 discussed these problems in memoranda to the Deputy Under Secretary for Field Coordination (see the following section) concerning preliminary reviews completed by each regional office. He also stated that the model preliminary review being developed will include examples of well-defined statements of weaknesses and corrective actions. He stated further that this model will be available before additional preliminary reviews are begun.

## HUD quality assurance process surfaces similar problems

In our 1984 report to the Secretary, we proposed that HUD give more attention to the quality assurance process. During this year's FMFIA efforts, HUD's Internal Control Coordinator evaluated the regional office preliminary reviews and observed some of the same problems we observed.

These preliminary reviews cover assessable units that deal with (1) the assignment of single-family mortgages—a process whereby under certain circumstances HUD takes over mortgages, (2) compliance—suspension and debarment—a process whereby builders and developers who do not comply with HUD requirements are suspended or barred from participating in HUD programs, and (3) single-family mortgagee monitoring servicing—a process whereby HUD monitors lenders for compliance with HUD loan servicing requirements.

These evaluations, completed in January 1985, covered adequacy of documentation, analytical work, and appropriateness of the corrective actions, including time frames for completion. On the basis of these evaluations, HUD staff concluded that many reviews were inadequate. As a result, the Assistant Secretary for Administration, in her January and February 1985 memoranda to the Deputy Under Secretary for Field Coordination, requested that about 60 of the 115 preliminary reviews be revised or completely redone before any new preliminary reviews are begun.

The Assistant Secretary's memoranda identified specific problems with individual reviews. For example, she told one region that all 10 of its preliminary reviews were unacceptable, explaining that they were poorly documented, were incomplete, and had inadequate corrective actions. The memoranda cited these problems as caused by insufficient staff time being applied to the process.

## Need to monitor process used to determine when to do an ICR

One of the objectives of HUD's preliminary review process is to decide whether an ICR is needed. Our review indicates that HUD evaluators have had difficulty in making the required cost-benefit determination. In all nine of the preliminary reviews we examined where the cost-benefit analyses were applicable, the evaluators did not complete the analyses. Nevertheless, they concluded that an ICR should not be done. HUD recognized this problem and will address it as it makes changes to its preliminary review process.

HUD's preliminary review instructions state that the objective of a preliminary review is to assess the causes of vulnerability established in the vulnerability assessment and select appropriate action to reduce or eliminate this vulnerability. The instructions define several alternative courses of action such as developing immediate corrective actions, requesting an Inspector General audit, or requesting that an ICR be performed. The instructions further stated that because it is not possible to expend the resources needed for ICRs on all vulnerable areas, the preliminary review is designed to identify areas that would benefit the most from an ICR.

We found, however, that the preliminary review process recommended few ICRs. Our random selection of 21 preliminary reviews in headquarters' housing programs and the Fort Worth and Chicago regional offices did not disclose any cases in which ICRs were recommended. In 1984 HUD's regional offices completed preliminary reviews for the first time. These offices recommended 9 ICRs in the 115 preliminary reviews made.

In determining whether an ICR is appropriate, HUD instructs the evaluator to review six selection criteria. If the programs meet any of these criteria the evaluator is instructed to analyze the costs and benefits of an ICR. The selection criteria involve determining such factors as whether several control weaknesses have been identified, some weaknesses are unknown, or problems are not clearly defined.

The cost-benefit analysis involves determining whether the estimated cost of vulnerability--not correcting an internal control problem--exceeds the cost of performing the ICR. Other than the form for recording the analysis, the preliminary review instructions provide no guidance on either how to interpret the selection criteria or how to determine the costs or benefits.

Our review of 15 preliminary reviews where the preliminary review questionnaire was available showed that the evaluator determined that the selection criteria were not met in 6 cases. As a result, the evaluators did not request an ICR. In nine cases the evaluator stated that one or more of the selection criteria had been met but did not request an ICR because it was not cost-beneficial. However, none of these preliminary reviews contained complete cost-benefit data.

For example, six of the reviews contained no cost data for either the vulnerability or the ICR and three showed costs only for the vulnerability. We discussed these three latter reviews with the evaluator who prepared them. He told us that originally he did not estimate any cost data, although he had concluded that an ICR would not be appropriate in the current environment of declining staff and funding. He added that the regional Internal Control Coordinator returned the reviews, so he estimated the costs of the vulnerability but not the ICR cost. Because of the importance of ICRs in assessing the adequacy of an agency's internal controls, we believe it is critical that this decision-making process be thorough.

In discussing our concern relating to the cost-benefit analysis and the few ICRs being recommended, the HUD Internal Control Coordinator told us that the criteria for determining when an ICR is appropriate need to be revised. He stated that HUD is not satisfied with the results being obtained from the criteria established. He added that, however, it may not be necessary to require evaluators to analyze costs and benefits, in part, because evaluators generally do not have necessary budgetary data to make this analysis.

HUD's Internal Control Coordinator also said that HUD is revising the entire preliminary review process and will give particular attention to determining when an ICR is appropriate. He further stated that he believes there is an underlying bias within the program staff against requesting ICRs and that this is the primary reason why few ICRs have been requested. He said that the program staff view ICRs as resource-intensive and to some extent an admission by managers that they are not aware of their own problems or are unable to correct them.

## HUD ICR REPORTS AND WORKPAPERS CAN BE CLARIFIED AND STRENGTHENED

HUD has performed most of its ICRs in the Office of Finance and Accounting. These reviews, performed by a contractor, have identified many internal control weaknesses in HUD's accounting operations and resulted in recommendations for numerous actions to strengthen these controls. However, we believe future ICRs can be improved if the ICR reports and supporting documentation (1) identify the control techniques directly related to the control objective they are intended to achieve and (2) clearly identify for each control technique the testing done by the reviewer to determine whether the technique is in place and functioning as intended.

The 36 ICRs completed in the Office of Finance and Accounting as of September 1984 (17 were completed during the first year) identified 240 weaknesses requiring corrective action. HUD's second annual report stated that 4 of the ICRs had disclosed material weaknesses and that 145 of the 240 weaknesses had been corrected. Our sample of five of the ICRs showed that they generally followed OMB's recommended approach for conducting an The reports included a discussion of the program background, review structure, transaction cycles (the processes used to initiate and perform related activities), control objectives (goals or conditions), control techniques (methods of protecting resources and achieving control objectives), and the evaluation of internal controls. For each transaction cycle, the reports listed applicable control objectives followed by a listing of control techniques and a discussion of the controls found to be inadequate. The reports also included an identification of risks to be avoided. According to the contractor this information on risks was included to indicate to management the consequences of not achieving the control objectives. The reports also stated that the contractor had tested the controls to determine whether they were functioning as intended. In this regard, the reports included a section describing review methodologies and testing techniques. Supporting documentation generally included a proposed testing plan.

### Matching internal control objectives and techniques

Although HUD's ICRs identified control objectives and control techniques, neither the reports nor the supporting documentation matched the control technique to the specific control objective they were intended to achieve. Although this step is not required by OMB or GAO, doing this will improve the ICR's usefulness to management.

For example, the ICR on the Congregate Housing Services Program identified three event cycles—funds control, disbursements, and reporting. Under each cycle, the report listed control objectives and techniques. For example, under the disbursements cycle, the report listed four control objectives, such as cash withdrawals by grantees are to be made for needed amounts. The objectives were followed by a listing of eight control techniques, such as providing routine financial data and checking for signature approval. However, the report did not match the techniques to the objectives. Therefore, we could not readily determine which techniques were in place to ensure that a particular objective was being achieved.

Although there is no specific requirement that control techniques be matched to specific control objectives, OMB guidelines state that an evaluation of internal controls within each event cycle includes determining whether appropriate internal control techniques are in place to enable control objectives to be met. We believe that matching the techniques to the specific objective they are intended to achieve will facilitate this determination. Such linkage would also make it easier for future HUD reviewers to understand the control structure and for HUD management to perform quality reviews of the ICRs.

In commenting on our draft report, the contractor noted that in its reviews, all objectives were related to all risks and techniques. The contractor agreed, however, that linking objectives to techniques would facilitate understanding of the control structure.

### Identifying testing performed

Our review of five ICRs showed that the reviewer did test the internal controls. However, the ICRs did not always clearly identify where in the supporting working papers the testing of specific controls was documented. As a result, it was difficult for us to evaluate the extent and type of testing related to each technique. For example, the ICR report on the \$3.5 billion Community Development Block Grant Program<sup>8</sup> showed that a

<sup>&</sup>lt;sup>7</sup>A program that provides assistance to residents of public housing to prevent premature or unnecessary institutionalization of those unable to prepare their own meals or who may require other services to remain independent.

<sup>&</sup>lt;sup>8</sup>A HUD program, established by the Housing and Community Development Act of 1974, as amended, that provides grants to states and units of local government for decent housing, a suitable living environment, and expanded economic opportunities primarily for low- and moderate-income people.

reporting cycle had been identified. However, we were unable to identify from reviewing the ICR report and supporting working papers which particular working paper documented the testing done to evaluate the reporting cycle controls' adequacy.

The contractor informed us that it tested for the reporting cycle controls while performing another ICR on HUD's Program Accounting System. In addition, the contractor provided working paper references, which we found helpful in understanding the testing done. However, we believe that in the future, ICRs should clearly identify the working paper that documented the testing done to determine whether each control technique functioned properly. To illustrate, the Community Development Block Grant ICR should have indicated that the reporting cycle was tested as part of another ICR and provided a reference to the specific working papers for that ICR, which documented the testing done. In this regard, the contractor, in a memorandum to the HUD Government Technical Representative, indicated that it could develop additional working paper documentation in the future to make it easier to follow the work performed. The contractor stated that some additional time may be necessary to accomplish the additional work.

The Director, General and Program Accounting Group, Office of Finance and Accounting, informed us that because existing OMB guidelines call for ICRs to be done by the agency's management staff, creating extensive documentation requirements may be beyond the intent of the Congress in passing the act. He stated, however, that he would evaluate the feasibility and cost of improving documentation. We are not suggesting extensive additional documentation but rather that the supporting working papers should clearly indicate where the testing performed on each control technique is documented. Such documentation would facilitate future HUD reviews of the same programs and would make it easier for HUD management to assess the quality of ICRs.

In commenting on our draft report, the contractor noted that each ICR contained a general discussion of the testing techniques used and that specific techniques were detailed in a plan outlining the proposed testing. With respect to our example, the contractor noted that the test plan identified the controls to be tested, including reporting. Further, he said, general problems relating to reporting were addressed by observation and interviews with HUD staff. These and other tests, he noted, were documented to the extent considered necessary. He concluded, however, that the inclusion of more explicit references to the testing would have facilitated an understanding of its accomplishment.

### CONCLUSIONS

In its second year under FMFIA, HUD has made progress in implementing a process to evaluate its internal controls. Its

efforts have essentially been an extension and refinement of the process initiated during the first year. Through this process, HUD has identified control weaknesses and actions intended to correct them.

HUD has also taken several actions in response to proposals made in our first year's report to strengthen its internal control evaluation process. In particular, HUD developed a framework for evaluating its ADP systems. However, it had not completed any systems evaluations during its second year under the act; thus, the new process had minimal impact on HUD's internal control evaluation for fiscal year 1984. Evaluating ADP systems will put HUD in a better position to report on the condition of its internal controls.

HUD's process can be further strengthened in several respects. Vulnerability assessment forms did not provide for identifying weaknesses requiring immediate corrective actions and did not adequately explain the basis for the vulnerability rating. In addition, preliminary reviews did not always specifically define the nature and extent of the weaknesses and corrective actions. Also, the ICRs or supporting documentation did not always clearly identify where testing of control techniques was documented.

Further, HUD evaluators did not always complete the required analysis for determining whether to perform an ICR. However, because HUD recognizes this problem and plans to address it as it revises its preliminary review process, we are making no recommendation. Additionally, HUD's ICRs did not identify the control techniques directly related to the objectives they were intended to achieve. Such matching would make it easier to determine whether the objectives were being met. However, because there is no specific requirement for such matching, we are making no recommendation.

### RECOMMENDATIONS

To strengthen the ICR process and to be in a better position to assess the reasonableness of HUD's internal controls, HUD's Secretary should direct the Assistant Secretary for Administration to

- --revise (1) vulnerability assessment guidelines to provide examples of the type and specificity of documentation needed to support the vulnerability rating assigned and (2) the vulnerability assessment form to provide space for identifying weaknesses requiring immediate corrective actions and the proposed actions;
- --revise the preliminary review guidelines to require evaluators to identify specific sources of information supporting conclusions reached and clearly explain the

nature and extent of the weaknesses and the specific actions necessary to correct them; and

--require that ICR reports and/or supporting documentation clearly identify the testing performed to determine whether control techniques are in place and operating as intended.

#### AGENCY COMMENTS

In commenting on our draft report, HUD's Deputy Assistant Secretary for Administration stated that he was in general agreement with our recommendations and that evaluation efforts such as ours were helpful to HUD in improving its internal control program. However, HUD made several comments to clarify or modify statements contained in our draft report. (See app. II.)

Specifically, HUD was concerned that our draft report gave the impression that their ICRs did not meet OMB guidelines and that there was no support for the controls tested, or how they were tested.

HUD noted that each ICR report contained a section that described the review methodology and indicated the testing techniques used. Further, HUD noted that the working papers for each review contained a plan outlining how the technique would be tested.

With respect to our example on the Community Development Block Grant Program, HUD stated that, as it had previously informed us, the testing of the reporting cycle had been done during the Program Accounting System review. HUD agreed that the working papers for the Block Grant ICR should have been referenced to the Program Accounting System review working papers.

We did not intend to imply that the ICRs did not comply with OMB guidelines or that there was no support for the controls tested, and we have revised our report accordingly (see Identifying testing performed, ch. 3). In addition, we recognize that the extent to which testing is documented and identified is often judgmental. However, we believe that the more explicitly the testing documentation is identified the more it will facilitate understanding of the work.

#### CHAPTER 4

### ACCOUNTING SYSTEM IMPROVEMENTS UNDERWAY,

### BUT REVIEW AND REPORTING IMPROVEMENTS NEEDED

In his second annual report to the President and the Congress, the Secretary stated, as he had in the prior-year's report, that HUD's accounting systems were not in full compliance with the Comptroller General's principles, standards, and related requirements. He also reported that HUD plans to enhance and redesign these systems to bring them into compliance by fiscal year 1988.

Our review showed that HUD has made progress in enhancing and redesigning its accounting systems. However, we also found that the Secretary's report did not clearly address most of its approximately 32 automated and manual systems. Specifically, HUD only elaborated on the condition of its three major accounting systems. Accordingly, it is not clear whether the Secretary's report applied to all of HUD's accounting systems or only the three major systems. More importantly, except for one new system, HUD did not do a detailed evaluation of any of its systems for conformance. 1

We agree that the systems elaborated on in the Secretary's report were not in conformance with the Comptroller General's principles, standards, and related requirements. However, in the future HUD should clearly state the extent to which all of its accounting systems do or do not conform. HUD also should complete system evaluations of its systems for which conformance has not been determined.

Although HUD uses the term "compliance" in its annual report, section 4 of the act uses the term "conformance" when discussing accounting system adherence to the Comptroller General's principles, standards, and related requirements. Henceforth, the term "conformance" will be used in lieu of "compliance" in this report.

The GAO Policy and Procedures Manual for Guidance of Federal Agencies contains the principles, standards, and related requirements to be observed by federal agencies. Specifically, title 2 prescribes the overall accounting principles and standards, and titles 4, 5, 6, and 7 specify requirements governing claims; transportation; pay, leave, and allowances; and fiscal procedures, respectively. In addition, agency accounting systems must include internal controls that comply with the Comptroller General's internal control standards and related requirements such as the Treasury Financial Manual and OMB Circulars.

### OVERVIEW OF HUD ACCOUNTING SYSTEMS

HUD has at least 12 automated and 20 manual accounting systems. These systems can be broken into four separate groups:

- --Accounting for administrative functions is handled by at least three automated and three manual systems. The major automated system during fiscal year 1984 was the General and Administrative Accounting System, which accounted for appropriations of \$301 million.
- --Accounting for assisted-housing programs is currently handled through at least five automated accounting systems, such as the Assisted Housing Accounting System and the Maturity Register System. The Assisted Housing Accounting System accounted for programs involving approximately \$13.6 billion in fiscal year 1984. The Section 8 Accounting System, which is not yet fully implemented, will also be in this group.
- --Accounting for programs other than assisted-housing is handled through at least 3 automated and 17 manual systems. One major automated system, the Program Accounting System, accounted for various appropriations totaling about \$4.6 billion in fiscal year 1984.
- --Accounting for personnel/payroll functions is performed by one automated system, the Terminally Operated Personnel/Payroll System. In March 1984 the OMB asked HUD to replace this personnel/payroll system with a more cost-efficient existing government system by October 1985. In October 1984 HUD established a task force to accomplish this.

HUD also has several Federal Housing Administration fund accounting systems, which HUD is not required to report on under FMFIA. Thus, these systems are not discussed in this report.

### HUD RECOGNIZES ACCOUNTING SYSTEM PROBLEMS AND HAS IMPROVEMENTS UNDERWAY

The Secretary of HUD, in his second annual report to the President and the Congress, stated that HUD's accounting systems were not in full conformance with the Comptroller General's principles, standards, and related requirements as of September 30, 1984. The Secretary based his conclusion on the results of an internal study and prior OIG and GAO reports that were critical of HUD's accounting systems.

In his 1984 report the Secretary described HUD's three major accounting systems--General and Administrative Accounting,

Program Accounting, and Assisted Housing Accounting—as cumbersome, costly to change or enhance, error-prone, difficult to control, and time—consuming to operate and reconcile. The Secretary further stated that HUD has a major project underway that entails replacing the General and Administrative Accounting System, technically upgrading the Program Accounting System, and improving or replacing the assisted—housing systems with one integrated, automated assisted—housing accounting system. The Secretary stated that with these improvements, the Department will have accounting systems in place that meet the Comptroller General's requirements by fiscal year 1988.

Our review showed that HUD has initiated actions to improve its accounting systems. These efforts, along with the planned improvements, if properly implemented and managed, should address identified problems.

## The General and Administrative Accounting System is being replaced

According to the Deputy Director for Accounting Policy and Planning, HUD is in the process of replacing its General and Administrative Accounting System, which processes transactions in batches, with the Administrative Accounting System, which can process individual transactions immediately. HUD considers the General and Administrative Accounting System to be fragmented, labor-intensive and error-prone. The system also has poor controls over duplicate payments. The Secretary stated that the new Administrative Accounting System will improve report accuracy and timeliness with its on-line capabilities. The system is supposed to control duplicate payments through automatic edits in the system.

The new system is also designed to perform administrative fund control and budgetary control functions for HUD. HUD expects the system to provide accounts payable details and maintain a general ledger for each administrative fund. HUD also expects it to generate various reports required by the Department of the Treasury, such as the Statement of Income and Retained Earnings and the Statement of Financial Condition.

# HUD documents and tests Administrative Accounting System

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In our first-year report on HUD's FMFIA efforts, we proposed that HUD document and test accounting systems as they are redesigned to help ensure their conformance with our principles and standards. During 1984 HUD prepared documentation of its Administrative Accounting System, including listing system objectives, established procedures, control features, and specific reports generated. Further, HUD used

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GAO's Statement of Accounting Principles and Standards for Federal Agencies as a checklist to review the system's design for conformance.

HUD personnel completed the checklist on the basis of their knowledge of the design. Additionally, HUD tested the new system prior to its implementation to determine whether it operates as designed and that transactions go through properly. HUD processed several months' transactions for one administrative fund through both the new system and its predecessor, the General and Administrative Accounting System, and compared and checked the results for errors. HUD personnel involved in the system's implementation told us that some corrections were made to the new system on the basis of the test, but that they did not find any serious system problems. Furthermore, the Director of General and Program Accounting told us that HUD intends to perform a conformance evaluation of the new system in operation during fiscal year 1985.

We believe system documentation and early testing, such as that performed by HUD for the Administrative Accounting System, can help HUD avoid some of the system development problems experienced in the past. Early testing also can help HUD avoid the cost and effort of correcting system problems after systems are implemented. We encourage HUD to take similar steps as it redesigns other systems.

### Program Accounting System undergoing a technical upgrade

The Program Accounting System is being technically upgraded in two phases to replace obsolete features and respond to report accuracy and timeliness problems. The first phase added the capability to generate reports for special purposes and replaced an obsolete data base with a state-of-the-art data base. HUD expects this phase of the upgrade, completed in October 1984, to allow the Program Accounting System to provide more timely reports.

The second phase, begun in November 1984, will replace error-prone and slow batch processing with on-line data entry and editing. HUD officials expect this phase to improve report accuracy and to be implemented by January 1986.

## Measures are being taken to improve assisted-housing accounting systems

HUD recognizes that the current assisted-housing accounting systems have numerous problems. According to HUD, these systems are labor-intensive, do not have complete accounting functions, and have supplemental manual processes that are subject to

error, abuse, or fraud. HUD's OIG also has reported assisted-housing accounting system weaknesses. HUD has undertaken improvements to address some of these known problems.

For example, a 1980 OIG review found that HUD's financial statements may not fairly present assisted-housing obligations. The OIG found that financial statements were not reconciled to related accounting records and that HUD should follow a prior GAO recommendation to record obligations on the basis of contracts. In response to this finding, HUD initiated a project, completed in September 1984, to reconcile obligation figures in the assisted-housing accounting systems with contract documents for the approximately 37,000 assisted-housing projects.

In another case an OIG/Office of Finance and Accounting Joint Project reported that HUD field staff did not have ready access to records needed to control fund advances to public housing authorities. In October 1983 HUD implemented the Maturity Register System to correct this problem by allowing field staff access to detailed project records. Furthermore, according to the Director of the Assisted Housing Accounting Division, by automating the recording of low-rent housing project note sales, the Maturity Register System has allowed HUD to reduce the staff needed to perform this function.

Additionally, the Director of the General and Program Accounting Group told us that HUD had developed an automated system to replace the labor-intensive manual process used to account for section 8 public housing program disbursements. The new system has controls designed to prevent duplicate payments of section 8 funds. As of January 1985, 7 of HUD's 10 regions had begun to implement this system; HUD's goal is to have it fully operational in all regions by the end of fiscal year 1985.

HUD also expects to address other known problems in accounting for assisted-housing programs by developing one integrated assisted-housing accounting system. However, as of April 1985 HUD's plans for implementing this system were uncertain. According to the Director of General and Program Accounting Group, an attempt to contract for an integrated system was cancelled because few bids were received due to restrictions in the request. In addition, according to the Director of the Assisted Housing Accounting Division, plans to modify or replace existing systems to form one integrated assisted-housing accounting system are pending a possible legislative proposal that would change assisted-housing programs to grant programs.

### IMPROVED REPORTING AND SYSTEM EVALUATION IS NEEDED TO MEET THE OBJECTIVES OF SECTION 4

Although HUD has initiated efforts to improve some accounting systems and bring them into conformance with the Comptroller General's requirements, more can be done to meet the objectives of section 4 of the act. We found that (1) HUD's fiscal year 1984 report did not clearly address all accounting systems and (2) HUD did not evaluate its systems for conformance.

### HUD's report did not clearly address all accounting systems

Our review showed that the Secretary's report did not clearly address all of its automated and manual systems. Specifically, HUD only elaborated on the condition of its three major accounting systems—General and Administrative Accounting, Program Accounting, and Assisted Housing Accounting.

In his annual report to the President and the Congress, the Secretary reported as follows:

"Pursuant to Section 4 of the "Federal Managers' Financial Integrity Act of 1982," we are providing our annual statement concerning the condition of the accounting systems of the Department as of September 30, 1984.

As of September 30, 1984, great progress was made toward bringing the accounting systems into compliance with the Comptroller General's requirements. While much has been done by the Department in the last 12 months, more remains to be done. Therefore, as of September 30, 1984, we must again report that our accounting systems are not in full compliance with the principles, standards, and related requirements of the Comptroller General."

The report named HUD's three major accounting systems--General and Administrative Accounting, Program Accounting, and Assisted Housing Accounting--and described in some detail their weaknesses and actions taken or planned to improve the systems. The report also stated that HUD planned to replace its Terminally Operated Personnel/Payroll System.

HUD has at least 8 other automated and 20 manual accounting systems that were not specifically addressed in the Secretary's annual report. Some of these systems account for

large dollar amounts. For example, one of the automated systems maintains the general ledger and prepares reports for several public housing programs, which had outlays of nearly \$2.8 billion in fiscal year 1984. One of the manual systems accounts for the payments for operation of low-income housing projects, which in fiscal year 1984 received an appropriation of nearly \$1.4 billion and made outlays of about \$1.1 billion.

In April 1985 the Director of the Office of Finance and Accounting told us that the Secretary's report was intended to cover all of HUD's accounting systems. However, the Director also stated that until the accounting system evaluation reviews initiated in fiscal year 1985 are completed in fiscal year 1986, HUD will not know the extent to which all of its systems do or do not fully conform.

### No detailed conformance evaluations performed

HUD did not do a detailed evaluation of its accounting systems for conformance with the Comptroller General's principles, standards, and related requirements. HUD did not evaluate the three major systems elaborated on in its annual report because it is replacing or redesigning them. However, as discussed previously, we identified at least 8 other automated and 20 manual systems, some of which will not be a part of HUD's project to develop an integrated accounting system. None of these systems were evaluated.

HUD's decision not to evaluate systems undergoing redesign was reasonable. However, HUD should have evaluated those that were not being redesigned and for which conformance had not been determined. The Deputy Director for Accounting Policy and Planning told us that during fiscal year 1985, HUD began to evaluate its systems for conformance. Further, he said these reviews involve testing.

We are encouraged by HUD's plans to evaluate its accounting systems for conformance. To determine whether a financial system conforms to the principles, standards, and related requirements prescribed by the Comptroller General, it is necessary to review and test the system in operation. Although HUD personnel may have extensive system knowledge, systems may operate differently than they believe. Therefore, testing should be done on critical aspects of the system, and may include

- --interviewing persons who operate the system,
- -- observing operating procedures,
- --examining system documentation,

- --applying procedures to live transactions and comparing results,
- --direct testing of computer-based systems by use of simulated transactions, and
- --reviewing error reports and evaluating error follow-up procedures.

Tests should be designed to disclose whether valid transactions are processed properly and whether the system rejects invalid transactions. The tests should cover the entire transaction, from initial authorization through processing, posting to the accounts, and reporting. Accordingly, manual as well as automated operations should be included. In developing test plans, consideration should be given to the results of any prior system testing.

OMB has adopted this testing criteria and has included it in Appendix H of its publication, <u>Guidelines for Evaluating Financial Management/Accounting Systems</u> (May 20, 1985). In determining the tests that would be appropriate for any system, it is important to keep in mind that in most cases, using transaction testing as the key, more than one of the techniques mentioned is needed to test all important aspects of an accounting system.

#### CONCLUSIONS

We agree that the accounting systems elaborated on in HUD's report did not conform with the Comptroller General's principles, standards, and related requirements during fiscal year 1984. We are encouraged by HUD's effort to improve and redesign its accounting systems as well as by measures to correct some of its accounting system weaknesses. We believe the system improvements, if properly implemented, should address weaknesses previously identified in these systems.

However, our review showed that HUD needs to improve its efforts for reporting and reviewing its systems under the act. Specifically, the Department needs to (1) clearly address the condition of all its accounting systems and (2) complete evaluations, including testing of its automated and manual systems for which conformance has not been determined.

#### RECOMMENDATIONS

We recommend that the Secretary clearly state in his annual report the extent to which all of HUD's accounting systems do or do not conform to the Comptroller General's principles, standards, and related requirements.

We also recommend that the Secretary direct the Assistant Secretary for Administration to complete the evaluations of its systems for which conformance with the Comptroller General's principles, standards, and related requirements has not been determined. The evaluations should include testing to ensure that the systems are operating as designed.

#### AGENCY COMMENTS

Although HUD generally agreed with our recommendations, it had several specific comments, which it believed clarified or modified imprecise and incorrect statements in our draft report. Generally, these comments supplemented or revised the data provided to us during our review. HUD stated that while it did not do a detailed evaluation of its accounting systems, it evaluated them on the basis of its knowledge of the systems and past GAO and IG audit reports, which identified them as not being in conformance with GAO standards. HUD further stated that the General and Administrative Accounting System has not, as we stated in our draft report, been fully replaced by the Administrative Accounting System. HUD also provided additional information on its efforts to (1) develop an integrated system for assisted-housing programs and (2) review its accounting systems for conformance.

We have discussed these comments with HUD's Deputy Director for Accounting Policy and Planning and have made minor changes to reflect the additional information provided by HUD. Regarding our discussion in this chapter of HUD's integrated system for assisted-housing programs, this official generally agreed with the accuracy of our statements. Accordingly, we made no changes.

### HUD ACTIONS ON GAO

### PRIOR-YEAR FMFIA PROPOSALS

Proposal: Extend the vulnerability assessment process to include all field office tiers, revise the assessment forms to require a separate preliminary evaluation of safeguards, and standardize the various assessment forms used by the different HUD organizations.

The HUD Internal Control Coordinator told us that he is interested in revising and standardizing the vulnerability assessment format. He said that HUD is considering performing vulnerability assessments in some of the larger field offices on a trial basis as part of the next round of vulnerability assessments.

Proposal: Establish guidance to ensure that sufficient documentation is developed and retained to provide a record of procedures used, and bases and factors considered in reaching overall conclusions on segmenting, vulnerability assessments, and internal control reviews.

In March 1984 HUD issued revisions to its internal control handbook that included additional guidance on documentation. However, as discussed in chapter 3, we believe this guidance can be improved. Our review work in 1985 disclosed additional areas with documentation problems that are addressed in chapter 3 of this report.

Proposal: Establish specific criteria on the type and extent of quality assurance procedures that HUD's Internal Control Coordinator should perform on the internal control evaluation process.

As discussed in chapter 3, HUD performed its own quality assurance evaluation of the regional office preliminary reviews. This evaluation identified problems with many of these reviews.

Proposal: Ensure that ADP controls are evaluated as part of the internal control evaluation process. To assist in accomplishing this, HUD should assign organizational responsibility and establish guidelines for evaluating ADP controls.

The Assistant Secretary for Administration designated the Director of the Office of Information Policies and Systems (OIPS) as responsible for implementing the ADP internal control evaluation process. The Director, in turn, delegated day-to-day responsibility for this process to the head of the Information Policy and Management Division. This responds to the proposal

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in our 1984 report to establish organizational responsibility for assessing ADP controls.

The major initiatives within OIPS this year concerning internal controls involved resegmenting and defining all principal automated systems as assessable units. As a first step in evaluating ADP controls in ADP systems that concern program managers--called application controls 1--OIPS surveyed headquarters program managers to consider various aspects of ADP operations including system criticality and sensitivity. Criticality involves determining the type of backup facilities needed on the basis of such factors as frequency of output and processing time. Sensitivity concerns the confidentiality of the data and safeguards necessary to avoid consequences of unauthorized access to and use of the system. The survey was designed to obtain general information covering such areas as system documentation, software reliability, audit trails, and output data accuracy. As a result of this survey, HUD designated 50 areas as assessable units.

As the next step in its ADP evaluation, HUD is performing vulnerability assessments on these 50 systems, or assessable units. Both users of the systems as well as the systems support personnel within OIPS are being asked by the Internal Control Coordinator within OIPS to complete a checklist evaluating the vulnerabilities of the systems. OIPS will then evaluate these checklists along with the already completed criticality/ sensitivity survey, and develop a vulnerability rating. As of the end of February 1985, no vulnerability assessments of ADP systems had been completed, although they were in progress.

For those systems not designated as assessable units, program managers will evaluate them as part of their ICR process when evaluating their own programs. If an ICR is done, those systems are to be included as an event cycle.

In spite of the progress cited above, HUD did not include some areas that we believe should have been part of its evaluation of ADP controls. Excluded were regional users of headquarters systems and regionally unique ADP systems. The OIPS Internal Control Coordinator told us that he recognizes this shortcoming and that it would be addressed in the future.

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ADP application controls are part of software systems and control the quality of data input, processing, and output. Application controls are usually evaluated by the program managers who use the systems. The scope of these controls relates to specific ADP tasks in individual software applications.

APPENDIX I

Concerning OIPS evaluation of its own organizational areas, which are included in the area of general controls, OIPS also resegmented and created new assessable units. For example, major contracts administered by OIPS to operate its data processing center were separately identified as assessable units. OIPS now has 21 organizational assessable units and has completed vulnerability assessments on them. Four of these units were rated as moderately vulnerable, the remainder as having low vulnerability. OIPS plans to perform preliminary reviews on the moderately rated units.

OIPS has also adopted an internal controls checklist for part of its vulnerability assessment process. This checklist includes sections on such ADP areas as organization, security, maintenance, documentation, and system controls. OIPS plans to use this checklist as part of its future vulnerability assessments. This checklist is responsive to our 1984 report proposal that HUD needs to establish guidelines for evaluating its ADP controls.

Proposal: Review accounting systems for compliance with principles and standards by requiring documentation and testing of accounting systems as they are redesigned.

HUD's actions on section 4 are discussed in chapter 4.

<sup>&</sup>lt;sup>2</sup>ADP general controls govern overall functions, such as organization and management, systems development, and computer operations. General controls affect the quality of services rendered to system users and are usually evaluated by ADP managers as part of an agency's review of the general control environment.

### ADVANCE COMMENTS FROM THE

### DEPARTMENT OF HOUSING AND

### URBAN DEVELOPMENT

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT WASHINGTON, D.C. 20410-3000

August 30, 1985

OFFICE OF THE ASSISTANT SECRETARY POR ADMINISTRATION

Mr. J. Dexter Peach, Director Resources, Community, and Economic Development Division United States General Accounting Office Washington, DC 20548

Dear Mr. Peach:

I have reviewed the General Accounting Office draft report, "The Department of Housing and Urban Development's Second-Year Implementation of the Federal Managers' Financial Integrity Act," and am in general agreement with its recommendations.

I have several specific comments which will clarify or modify imprecise or incorrect statements in the draft report. These are presented in the enclosure to this letter.

Fully and effectively implementing the Federal Managers' Financial Integrity Act is a complex undertaking to which this Department attachs a high priority. As the draft report notes, we continue to make progress, and we find evaluative efforts such as was done by your staff helpful to us in improving HJD's internal control program.

Sincerely,

Donald J. Keuch, Jr. Deputy Assistant Secretary

Enclosure

HUD COMMENTS ON GAO DRAFT REPORT "THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT'S SECOND-YEAR IMPLEMENTATION OF THE FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT"

See comment 1.

1. Page ii, Paragraph 3. The report states "HUD did not evaluate its accounting systems for conformance with GAO's standards . . . "

While we did not do a detailed evaluation of our accounting systems, we evaluated them based on our knowledge of the systems and past GAO and IG audit reports which identified them as not being in conformance with GAO standards. We concluded, based on this evaluation, that our systems were, in fact, not in conformance with GAO standards.

We suggest this sentence be revised to state that: "HUD did not perform a detailed evaluation of its accounting systems . . . ."

Now on p. 15. See comment 1.

2. Page 21, Paragraph 2. The report names HUD's contractor which we do not feel serves any useful or meaningful purpose to the reader of the report. The contractor's name should be deleted from the report.

Now on p. 15. See comment 1. 3. Page 21, Paragraph 3. The report states that "HUD had 143 systems in operation . . ." The reference to 143 systems is misleading since all of these systems are not accounting or financial management systems.

We suggest this sentence be revised to state that: "In Fiscal Year 1984 HUD had 143 systems in operation (including all financial and non-financial systems) and . . . ."

Now on pp. 24 to 28.

4. Pages 35-41. This section of the report, entitled "HUD ICR Reports and Workpapers can be Clarified and Strengthened," needs some clarification. (GAO requested and received a response to certain portions of this section of the draft audit report from HUD's contractor. The Department also provided detailed comment in a January 9, 1985 memorandum to GAO staff from Mr. Robert H. Martin, Director, General and Program Accounting Group, Office of Finance and Accounting.)

See comment 1.

a) This section of the GAO report fails to mention an added dimension to the ICRs performed by the contractor which is not required by OMB. Through agreement between the Office of Finance and Accounting (OFA) and the contractor, the ICRs contain an element of "Risks to be Avoided" which has assisted management in assessing the risks associated with failure to impose appropriate control techniques.

We request that this information be included in the report in order to provide proper balance.

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See comment 2.

b) Under the heading Identifying Testing Performed, we have some serious concerns. The first sentence under this heading is misleading and coupled with the second sentence gives the appearance that HUD's ICRs did not follow OMB guidelines. This is not true. Each of the ICR reports contains a section which describes the methodology of the reviews and indicates the testing techniques used during the review. Also, the working papers for each review contain a plan outlining how the techniques would be tested. This item was addressed in our response to GAO questions during this audit. Page 2 of our January 9, 1985, memorandum to GAO speaks directly to this item.

The first sentence in the second paragraph, under the same heading, is also misleading. A broad statement is made indicating that the ICR reports and documentation did not specify which controls were tested or how they were tested. In our January 9 response to GAO, page 11, we specifically addressed the example in our report. Our response indicated that the reporting cycle testing was completed during the Program Accounting System (PAS) ICR and that the working papers for the CDBG ICR should have been cross-referenced to the PAS ICR working papers. However, this does not support your statement that there was no support for controls tested or how they were tested.

We were of the impression that our January 9 response to GAO adequately answered their questions concerning these items. GAO should indicate what further action HUD needs to take to address these issues.

- Now on p. 33. See comment 3.
- 5. Page 49, Paragraph 1. This paragraph should indicate that although HUD did not let a contract for an integrated system, we have explored other options and developed another approach to an integrated system. Suggested revision: "In addition, HUD has concluded that an integrated system can be achieved by modifying or replacing existing systems using a modular approach. However, the modular approach to an integrated system is on hold pending a possible legislative proposal that would change assisted housing programs to grant programs."
- Now on p. 35. See comment 1.
- 6. Page 51, Paragraph 2. HUD has already begun to review its accounting systems, including testing of the systems, and anticipates that all systems will be reviewed for conformance with GAO's Principles and Standards during its FY 1985 closing process. This section should be updated to reflect this fact.
- Now on p. 31. See comment 1.
- 7. Page 45, Paragraph 3. It is not correct to state that the General and Administrative Accounting System, A93, has been fully replaced by the Administrative Accounting System, A98. The batch system, A93, is being upgraded over time into the on-line data entry system, A98. This conversion is not yet complete, and we request that this section be revised accordingly.

APPENDIX II APPENDIX II

The following are GAO comments on the Department of Housing and Urban Development's letter dated August 30, 1985.

GAO COMMENTS

- 1. Report revised.
- 2. This comment is discussed in chapter 3 of the report.
- This comment is discussed in chapter 4 of the report.

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